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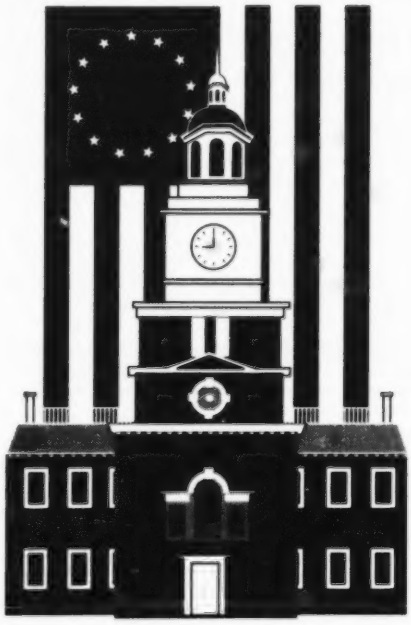
Reporting Income From Tips



Introduction

This publication can help you understand how your tip income is taxed, and how to report it on your Federal income tax return. Although tipped employees of food and beverage establishments are the focus of this publication, the recordkeeping rules and other information may also apply to other tipped workers such as hairdressers, cab drivers, and casino dealers.

All tips you receive are taxable income and are subject to Federal income tax. You must include in gross income all tips you receive directly from customers, all tips from charge customers that are paid to you by your employer, and your share of any tips you receive under a tip-splitting arrangement.

In addition, cash tips of $20 or more that you receive in a month while working for any one employer are subject to withholding of income tax and social security or railroad retirement tax. Report the tips you receive to your employer so that the correct amount of income and social security or railroad retirement tax can be determined.

Your tips and other pay are used to determine the amount of social security or railroad retirement benefits you or your family may receive if you retire, become disabled, or die. You can get information about these benefits from Social Security offices or Railroad Retirement Board offices. Noncash tips are not counted as wages for social security purposes.

To ensure that your future benefits are figured correctly and that you have received credit for all your earnings, you should request a statement of your earnings from the Social Security Administration periodically.

Every large food or beverage establishment must report to the Internal Revenue Service (IRS) any tips allocated to its employees. Generally, tips must be allocated to employees when the total tips reported to an employer by employees are less than 8% of the establishment's food and beverage sales. For more information, see *Tip Allocation*, later.

Free Publications and Forms

If you need information on a subject not covered in this publication, you may check our other free publications.

To order publications and forms, call our toll-free telephone number 1-800-829-3676 (1-800-TAX-FORM) or write the IRS Forms Distribution Center for your area as shown in the income tax package.

Reporting Tips

You must report all tips as wages on Form 1040, Form 1040A, or Form 1040EZ. This includes the value of tips not paid in cash, such as passes, tickets, goods, or services. If you received tips of $20 or more in a month and did not report all of them to your employer, you must file Form 1040.

Service charges. A club, hotel, or restaurant may require customers who use its dining or banquet rooms to pay a service charge, which is given to the waiters or waitresses and other employees. Your share of this service charge is not a tip, but is part of your wages paid by the employer. You should not include your share in your report of tips to your employer. Your employer should not include your share of the service charge as tips paid to you, but should include it in your wages.

Daily Record of Tips

You must keep a ***daily record*** or ***other evidence*** to prove the amount of tip income you report on your return.

Daily record. Your daily record must show your name and address, your employer's name, and the establishment's name. It must also show, for each workday, the amount of cash and charge tips you received directly from customers or from other employees, the amount of tips you paid out to other employees through tip sharing, etc., and the names of the other employees to whom you paid out tips.

Make the entries in your daily record on or near the date you receive the tip income.

You can use **Form 4070–A,** *Employee's Daily Record of Tips,* to keep this record.

Form 4070–A can be found in Publication 1244. You can get Publication 1244 from the IRS or your employer. A filled-in Form 4070–A is shown at the end of this publication.

Other evidence. If you do not keep a daily record of tips, you must maintain other evidence of the tip income you receive. This other evidence must be as credible and reliable as a daily record. This other evidence can be documentary evidence that shows tips added to a check and paid over to you or amounts paid for food or beverages on which you would generally receive a tip. Examples of documentary evidence are copies of restaurant bills, credit card charges, or charges under any other arrangement containing amounts added by customers as tips.

Your personal records. You should keep your daily tip record and a copy of the written reports you give your employer with your personal records.

When to Report Tips to Employer

You must give your employer a written report of your tips for each month by **the 10th day** of the next month. This report is required for each month that you receive tips of $20 or more while working for that employer.

Saturday, Sunday, holiday rule. If the 10th day of the month falls on a Saturday, Sunday, or legal holiday, you may give your employer the report on the next day that is not a Saturday, Sunday, or legal holiday.

Example. You must report tips of $20 or more you receive during January 1991 to your employer by Monday, February 11, 1991.

How to Report Tips to Employer

The following discussions refer only to tips paid by cash, charge, and check.

Less than $20 in tips in one month. If you receive less than $20 in tips while working for one employer during a month, you do not have to report them to that employer. But you must include the tips in gross income on your income tax return. You do not have to pay social security or railroad retirement tax on these tips.

$20 or more of tips in one month. If you receive tips of $20 or more in a month while working for any one employer, you must report the total amount of your tips to that employer by the 10th day of the next month.

Example 1. You work for Watson's Restaurant during the month and receive $75 in tips. Because your tips are more than $20 for the month, you must report the $75 to your employer.

Example 2. You work for Watson's Restaurant during the month and receive $17 in tips. In that same month you work for Parkview Restaurant and get $14 in tips. Even though your tips total $31, you do not have to report tips to either employer, because you received less than $20 in tips from each job. However, you should keep a

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record of the $31 because you must report it as income on your tax return.

Example 3. You work for Watson's Restaurant and receive $25 in tips. In that same month you work for Parkview Restaurant and get $12 in tips. Because your tips for Watson's Restaurant are more than $20 for the month, you must report the $25 to that employer. You do not have to report the $12 in tips you received while working for Parkview Restaurant to either employer. However, you should keep a record of the $12 because you must report it as income on your tax return with your other tips.

Tip splitting. If you split tips with fellow employees, such as waiters giving a part of their tips to busboys, include only your share of the tips in your report to your employer. "Tip splitting" may also be referred to as "tip sharing" or "tip pooling."

Your tip report to your employer should cover only one calendar month. But, your employer may require you to report your tips more often than once a month. For example, you may be required to report your tips weekly. In this case, you must make your report on the dates set by your employer.

When you stop working for your employer, you should report your tips of $20 or more to your employer at that time. If you do not report the tips when you stop working, you must give a statement to your employer either before your final payday or by the 10th day following the month you receive the tips, whichever is earlier.

Example. You stop working for Pizza Delivery in February after receiving $85 in tips for the month. You will receive your final pay in March. You must report your tips for February to your employer by the earlier of March 10 or the day before you receive your final pay.

Your tips are treated as paid to you when you make your written report to your employer. However, if you make no report to your employer, your tips are treated as paid to you when you receive them.

Example 1. During December 1990, you received $300 in tips. On January 10, 1991, you reported the tips to your employer. Your December 1990 tips will be treated as paid to you in January 1991, at the time you made the report to your employer. You must report the $300 on your 1991 income tax return.

Example 2. If during December 1990 your tips were only $18, you would not have to make a report to your employer. In this case, your tips are treated as paid in December 1990, the time you actually received them. You must report the $18 on your 1990 income tax return.

To report tips to your employer, you may use **Form 4070,** *Employee's Report of Tips to Employer.* This form, available in Publication 1244, tells you what information you must report. If you do not use Form 4070, your report should include the amount of tips, your employer's name and address, your name and address, your social security number, the month (or shorter period) covered, your signature, and the date of the report.

A filled-in Form 4070 is shown at the end of this publication.

Withholding on Tips by Employer

Your employer must withhold social security or railroad retirement tax and any income tax due on the tips you report. Your employer usually deducts the withholding due on tips from your regular wages. But you do not have to have income tax withheld if you can claim exemption from withholding.

Exemption from withholding. Income tax will not be taken out of your pay if you give your employer a filled-in **Form W–4,** *Employee's Withholding Allowance Certificate,* claiming exemption from withholding. You can claim exemption only if you had no income tax liability last year and expect none this year. To continue your exemption, you must file a new Form W–4 each year by February 15. See the instructions for Form W–4 to determine when you may no longer claim the exemption from withholding.

Employer's recordkeeping. Your employer may withhold an estimated amount from your wages to cover the tax on your tips. Your employer also may require your written tip reports more than once a month and may deduct the taxes due on your reported tips even though they do not yet total $20. If this is done, your employer must adjust the amount of taxes withheld from time to time, based on the actual amount of tips you report.

Form W–2. The Form W–2, *Wage and Tax Statement,* which you get from your employer, includes your reported tips in your regular wages. It shows separately your social security wages and your social security tips. These amounts are included in the "wages, tips, other compensation" block of the form. The form also shows the social security and income taxes withheld on your tips. Any errors you find in these amounts should be brought to your employer's attention as soon as possible so you can obtain a corrected form.

Pay too low. If your regular pay is too low for your employer to withhold all the tax due on your pay plus your tips, you may give your employer extra money to pay the tax. Your employer will tell you how much is needed.

If you do not give your employer enough, or any, extra money, your employer will first withhold as much social security or railroad retirement tax as possible, and then withhold income tax up to the full amount of your pay.

You may pay estimated tax instead of giving your employer extra money. Use **Form 1040–ES,** *Estimated Tax for Individuals.* See Publication 505, *Tax Withholding and Estimated Tax,* for more information on estimated tax.

Uncollected employee social security tax. Box 17 (code A) on your Form W–2 will show the amount of social security tax on tips that your employer was unable to withhold and for which you did not give your employer extra money to pay the taxes. You must file Form 1040, report the amount of uncollected tax on tips from Box 17 (code A) Form W–2, and pay it with your return, even if you do not otherwise have to file a return. Include the amount of uncollected tax in the total on line 54 of Form 1040. On the dotted line next to this total, write "Uncollected Tax on Tips" and show the amount.

Limit on social security tax and railroad retirement tax. The wages you received from a nonrailroad employer and the tips you reported to that employer were subject to the withholding of social security tax until they reached a total of $51,300 for 1990. Your employer withheld this tax at the rate of 7.65%. No more than $3,924.45 should have been withheld from your pay by any one employer in 1990.

Your pay and the tips you reported to your railroad employer were subject to the withholding of tier 1 railroad retirement tax until they reached a total of $51,300 for 1990. Your employer withheld this tax at the rate of 7.65%. In addition, your employer withheld tier 2 railroad retirement tax at the rate of 4.90% on the first $38,100 of your pay and tips. The maximum amount of railroad retirement tax that should have been withheld for services performed during 1990 is $5,791.35 ($3,924.45 + $1,866.90).

Two or more employers. If you worked for two or more employers in 1990, who together withheld more than $3,924.45 of social security tax or tier 1 railroad retirement tax, or $1,866.90 of tier 2 railroad retirement tax, you may claim the extra amount as a credit to reduce your income tax when you file your return. See *Excess Social Security or Railroad Retirement Tax Withholding* in Publication 505 for more information.

Overwithholding by one employer. If any one employer withheld too much social security or railroad retirement tax, you may not claim the extra amount as a credit to reduce your income tax. Your employer must adjust this for you.

Tier 1 railroad retirement and social security withholding. If you had both tier 1 railroad retirement and social security withholding, and the total withheld was more than $3,924.45, you may be able to claim a credit that will reduce your income tax. See *Excess Social Security or Railroad Retirement Tax Withholding* in Publication 505 for more information.

No limit for withholding of income tax. Unlike the social security and railroad retirement taxes, there is no dollar limit on the income tax withheld on wages and tips. The income tax withheld by your employer will either decrease what you owe at the end of the year or increase your refund when you file your return.

Penalties. To ensure that all taxpayers pay their fair share of taxes, the law provides penalties for failure to file returns or pay taxes as required. Some other penalties that may be charged include those for:

Not supplying a taxpayer identification number,

Filing a frivolous income tax return, or

Failing to report tips, discussed later.

Some penalties may not be charged if noncompliance was due to reasonable cause.

Penalty for false information on Form W–4. If you make statements or claim withholding allowances on your Form W–4 that decrease the amount of tax withheld and there is no reasonable basis for such statements or allowances at the time you prepare your Form W–4, you may have to pay a penalty of $500.

There is also a criminal penalty for willfully supplying false or fraudulent information on your Form W–4 or for willfully failing to supply information that would increase the amount withheld. The penalty upon conviction is a fine of not more than $1,000, or imprisonment for not more than one year, or both.

Tips Not Reported to Employer

If you received tips of $20 or more in any month while working for one employer, but did not report all of them to your employer, you must figure your social security tax on the tips not reported. You should use **Form 4137,** *Social Security Tax on Unreported Tip Income,* and attach it to Form 1040. Enter the tax on line 51 in the *Other Taxes* section on page 2 of Form 1040. You also must include these tips in income on line 7 of your Form 1040. You may not use Form 1040EZ or Form 1040A.

Employees subject to the Railroad Retirement Tax Act. If you received tips of $20 or more in any month while working for a railroad employer and did not report them to your employer, you should contact your nearest Railroad Retirement Board office for information on how to determine the amount of railroad retirement tax on unreported tips and how you can get railroad retirement credit for all your tips. You should pay the railroad retirement tax on unreported tips when you file Form 1040. Enter the tax on line 51 in the *Other Taxes* section on page 2 of Form 1040 and write "RRTA" next to it on the dotted line. You also must include these tips in income

on line 7 of your Form 1040. You may not use Form 1040EZ or Form 1040A.

Penalty for failure to report tips. If you do not report tips to your employer as required, you may be subject to a penalty equal to 50% of the employee social security or railroad retirement tax, in addition to the tax that you owe.

If you did not report tips to your employer as required, you should attach a statement to your return explaining why you did not report them.

Tip Allocation

Large food or beverage establishments are required to report to the IRS certain additional information about tips. To make sure that employees are correctly reporting tips, employers must keep records to verify amounts reported by employees. Certain employers must allocate tips if the percentage of tips reported by employees falls below a required minimum percentage of gross sales. To "allocate tips" means to assign an additional amount as tips to each employee whose reported tips are below the required percentage.

To whom the tip allocation rules apply. The rules apply to operations in which:

Food or beverages are provided for consumption on the premises,

Tipping is customary, and

The employer normally employed more than 10 people on a typical business day during the preceding calendar year.

Food or beverage operations where tipping is not customary do not come under the rules. For example, a cafeteria or a "fast food" operation would generally not be covered because tipping is not usually customary at these kinds of eating places. An operation is likewise not covered by the rules if it adds a service charge of 10% or more to 95% or more of its food or beverage sales. The rules also do not apply to food or beverage operations located outside the United States.

How the rules work. The rules apply only if the total amount of tips reported by all tipped employees to your employer is less than 8% (or some lower percentage) of the establishment's total food or beverage sales (with some adjustments).

If reported tips total less than 8% of total sales, your employer must allocate the difference between 8% of total sales and the amount of reported tips. (Your employer will exclude carryout sales, taxes, and sales with a service charge of 10% or more when figuring total sales.) The allocation is made among the employees who receive tips directly from customers, or among all tipped employees if an agreement between the employer and the employees provides for allocating them this way. However, no allocation will be made to you if you report tips at least equal to your share of 8% of total sales.

If customers of the establishment tip less than 8% on the average, either your employer or a majority of the directly-tipped employees (including those who turn their tips over to a tip pool) may petition to have the allocation percentage reduced from 8%. This petition is made to the district director for the Internal Revenue District in which the establishment is located. However, the percentage cannot be reduced below 2%.

Employees' petition. The petition to lower the allocation percentage must be in writing and must contain enough information to allow the district director to estimate the establishment's actual tip rate with reasonable accuracy. This information might include the charged tip rate, type of establishment, menu prices, location, hours of operation, amount of self-service required, and whether the customer pays or receives the check from the server.

If the employer possesses any relevant information, the employer must provide it to the district director upon request of the employees or the district director.

The petition must be consented to by more than one-half of the directly-tipped employees working for the establishment at the time the petition is filed. If the petition covers more than one establishment, it must be consented to by more than one-half of the total number of directly-tipped employees of the covered establishments. The petition must state the total number of directly-tipped employees of the establishment (or establishments) and the number of directly-tipped employees consenting to the petition.

A petition may cover two or more establishments if the employees have made a good faith determination that the tip rates are essentially the same and if the establishments are:

Owned by the same employer,

Essentially the same type of business, and

In the same Internal Revenue region.

A petition that covers two or more establishments must include the names and locations of the covered establishments and must be sent to the district director for the district in which the greatest number of covered establishments are located. If there is an equal number of covered establishments in two or more districts, the employees can choose which district director to petition.

Employees who file a petition must promptly notify their employer of the petition. The employer must then promptly furnish the district director with copies of any **Forms 8027,** *Employer's Annual Information Return of Tip Income and Allocated Tips,* filed for the establishment for the 3 immediately preceding calendar years.

Allocated tips on Form W-2. Your employer will report the amount of tips allocated to you on your Form W-2 (in Box 7) separately from your wages and reported tips. Your employer bases withholding only on wages and reported tips. Your employer ***should not withhold*** income, social security, or railroad retirement tax from the allocated amount. Any incorrectly withheld taxes should be refunded to you.

If you leave your job before the end of the calendar year and request an early Form W-2, your employer does not have to include a tip allocation on the Form W-2. However, your employer may show the actual allocated amount if it is known, or show an estimated allocation. In January of the next year, your employer must provide an amended Form W-2 to you if the early Form W-2 showed no allocation and your employer later determined that an allocation was required, or if the estimated allocation shown was wrong by more than 5%.

Allocation formula. The allocation can be done either under a formula agreed to by both the employer and the employees or, if they cannot reach an agreement in good faith, under a formula prescribed by Treasury regulations.

The allocation formula in the regulations provides that tip allocations are made only to directly-tipped employees. If you receive tips directly from customers, you are a directly-tipped employee, even if the tips are turned over to a tip pool. For example, waiters, waitresses, and bartenders are usually considered directly-tipped employees. If you do not normally receive tips directly from customers, you are an indirectly-tipped employee. Examples of indirectly-tipped employees are busboys, service bartenders, and cooks. If you receive tips both directly and indirectly through tip splitting or tip pooling, you must be treated as a directly-tipped employee.

Reporting allocated tips. If box 7 of your Form W-2 shows any allocated tips, you must include the allocated amount in gross income on line 7 of Form 1040 unless you can prove a lesser amount with adequate records. If you include allocated tips in gross income, use **Form 4137,** *Social Security Tax on Unreported Tip Income,* to figure your social security tax on the tips not reported to your employer. Attach Form 4137 to Form 1040. Enter the tax on line 51 in the *Other Taxes* section on page 2 of Form 1040. You may not use Form 1040EZ or Form 1040A.

Note: The tip allocation amount may be added to your gross income unless you are able to prove a lesser amount with adequate records. The IRS may determine that you received a larger amount of tip income than reflected by the tip allocation.

For more information about tip allocation, see Publication 937, *Business Reporting.*

Form **4070**
(Rev. March 1990)
Department of the Treasury
Internal Revenue Service

Employee's Report of Tips to Employer

▶ **For Paperwork Reduction Act Notice, see back of this form.**

OMB No. 1545-0065

Employee's name and address: John W. Allen 1117 Maple Ave. Anytown, NY 14202	Social security number: 987 00 4321
Employer's name and address (Include establishment name, if different.): Parkview Restaurant 834 Main Ave. Anytown, NY 14203	
Month or shorter period in which tips were received: from October 1 , 19 90 , to October 31 , 19 90	Tips: $ 1,269.60
Signature: John W. Allen	Date: November 6, 1990

Form **4070-A** (Rev. March 1990)

Employee's Daily Record of Tips

(This is a voluntary form provided for your convenience. See instructions for records you must keep.)

OMB No. 1545-0065

Employee's name and address: John W. Allen, 1117 Maple Ave., Anytown, NY 14202

Employer's name: Parkview Restaurant

Establishment's name (if different)

Month and year: October 1990

Date	a. Tips received directly from customers and other employees	b. Tips received on charge receipts	c. Tips paid out to other employees	d. Names of employees to whom tips were paid out
1	OFF	–	–	–
2	48.80	26.40	15.20	Judy Brown, Brian Smith
3	28.00	21.60	8.00	Judy Brown, Carl Jones
4	42.00	24.00	10.00	Judy Brown, Carl Jones
5	40.80	28.00	12.00	Judy Brown, Carl Jones
Subtotals	159.60	100.00	45.20	

For Paperwork Reduction Act Notice, see Instructions for Form 4070.

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Date	a. Tips received directly from customers and other employees	b. Tips received on charge receipts	c. Tips paid out to other employees	d. Names of employees to whom tips were paid out
6	OFF	–	–	–
7	37.20	22.40	8.00	Carl Jones, Brian Smith
8	50.80	17.20	10.00	Judy Brown, Carl Jones
9	33.60	16.40	8.00	Judy Brown, Brian Smith
10	30.40	22.00	9.20	Judy Brown, Carl Jones
11	42.00	11.60	8.80	Judy Brown, Carl Jones
12	35.60	16.00	7.60	Judy Brown, Carl Jones
13	OFF	–	–	–
14	48.40	14.40	12.40	Carl Jones, Brian Smith
15	45.20	32.00	17.20	Judy Brown, Carl Jones
Subtotals	323.20	152.00	81.20	

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Date	a. Tips received directly from customers and other employees	b. Tips received on charge receipts	c. Tips paid out to other employees	d. Names of employees to whom tips were paid out
16	41.20	18.40	8.80	Judy Brown, Brian Smith
17	39.20	21.20	9.60	Judy Brown, Carl Jones
18	46.80	12.80	8.40	Judy Brown, Carl Jones
19	34.00	19.20	10.00	Judy Brown, Carl Jones
20	OFF	–	–	–
21	34.80	26.00	12.80	Carl Jones, Brian Smith
22	42.40	22.80	12.40	Judy Brown, Carl Jones
23	48.80	17.20	13.60	Judy Brown, Brian Smith
24	33.60	19.20	10.80	Judy Brown, Carl Jones
25	37.20	14.80	9.20	Judy Brown, Carl Jones
Subtotals	358.00	171.60	95.60	

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Date	a. Tips received directly from customers and other employees	b. Tips received on charge receipts	c. Tips paid out to other employees	d. Names of employees to whom tips were paid out
26	31.60	11.60	12.40	Judy Brown, Carl Jones
27	OFF	–	–	–
28	43.20	14.00	12.80	Carl Jones, Brian Smith
29	34.80	22.40	7.20	Judy Brown, Carl Jones
30	46.00	27.20	12.80	Judy Brown, Brian Smith
31	27.60	20.40	6.40	Judy Brown, Carl Jones
Subtotals from pages 1, 2, and 3	159.60 323.20 358.00	100.00 152.00 171.60	45.20 81.20 95.60	
Totals	1,024.00	519.20	273.60	

Tips (col. a plus col. b minus col. c). Report this amount on Form 4070 . . ▶ 1,269.60

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*U.S.GPO:1990-517-016/22460